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AGRICULTURAL INSURANCE IN DEVELOPING COUNTRIES

Study by the UNCTAD secretariat

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1. Agriculture remains the dominant sector in a large number of developing economies. Many developing countries accord high priority to its development. But, despite its importance, the various initiatives taken for its development have often not delivered full benefits. The Second United Nations Conference on the Least Developed Countries recognized that, for an orderly growth of the agricultural and, more broadly, the rural sector, it is necessary to establish a comprehensive package programme of support services. Insurance is a part of this package. Agriculture is a risky business, being subject in particular to the vagaries of the weather. The variations in productivity induced by nature cannot be fully accommodated by farmers, and in this respect insurance has a role to play. Agricultural insurance can contribute to the economic and social stability of the country by mitigating the risks of sharp fluctuations in the incomes of the farming community.

2. Timely availability of credit is an essential element for the development of agriculture. Agricultural insurance has a distinct role as security for credit. It makes the farmer a better credit risk. Moreover, insurance is a certain payment for an anticipated future event and thus is an instrument of saving. It can facilitate the release of "sterile assets" such as gold and jewelry, thereby speeding up the monetization of the rural economy. Another area where insurance is of relevance is in improving agricultural technology. By enabling the farmer to avoid sub-optimal decisions in production, insurance can stimulate additional borrowing and investment. Insurance can also optimize the efforts of governments in many countries to provide aid and relief in the event of a natural catastrophe.

3. Crop insurance is the most widely discussed aspect of agricultural insurance. However, the scope of agricultural insurance is much broader. Horticulture, plantations, forestry, viniculture, and the rearing of animals such as livestock, as well as poultry farming, aquaculture, aviculture, sericulture and apiculture are all agricultural activities. In its generic sense agricultural insurance extends to the entire production process including the post-harvest stage, processing and the transportation of products to the final markets. Further, the capital assets employed in the production processes, including dwellings, machinery, draught animals, equipment and implements, processing plants, etc. also require protection. Rural households, handicrafts and small sector production processes, and people engaged in these activities as well as in agriculture all fall within the scope of insurance. In fact, wherever investments are made, and substantial investments are being made in the agricultural sector, there is a role for insurance.

4. National insurance markets have by now been established in most of the developing countries and, despite several handicaps, have grown appreciably. However, for various reasons the operations are largely confined to urban areas. In many developing countries, the share of the modern sector is stagnant and even declining. Moreover, with the possibilities of liberalization of services and a reduction of restrictions, the urban sector insurance business is likely to become increasingly competitive. The agricultural and rural sector, on the other hand, offers opportunities which must be realized, both in the long-term interest of domestic companies and of the development of the national economy.

5. As the characteristics of different agricultural units vary widely, a common approach to insurance of all sections is difficult. Consequently, it is helpful for agriculture to be broadly classified into the following four sectors on the basis of their organizational pattern and extent of commercialization: traditional or subsistence, semi-commercial and emerging, commercial, and specialized production systems. When agricultural insurance in developing countries is discussed, it is usually with reference to traditional and subsistence agriculture. The problem of this sector is that farmers are normally below the "threshold of insurability" for the products offered. Usually the cover given is wide, almost on an "all-risk" basis. Premiums are set below the actuarially required level, and are often subsidized. No margins are kept for fluctuations and risk management aspects are not given importance. Insurance is seen as an instrument of government policy. The schemes are, therefore, commercially unviable, and the State has to fund the deficit. Private sector companies are unable to play a role. Most of these schemes are managed by parastatal organizations. Wide-ranging discussions have taken place about these schemes and it has been argued that they do not serve much purpose. Few welfare gains are claimed to accrue. Agricultural productivity does not improve, and the subsidy becomes a locked-in commitment. Thus, the resources of the State are not utilized productively.

6. Based on a review of the practices followed in many developing countries, it appears that a better option would be to provide a scheme with a high franchise, say, 40 to 50 per cent, to this sector of farmers. It would be in the nature of a safety net so that, in the event of a severe setback in production, the farmer will not be totally disabled. In any case, he would be able to face minor variations through traditional methods of risk aversion. The advantage would be that the extent of State support would be substantially less, and not open-ended, as is the case in many of the schemes at present.

7. Private sector companies are unlikely to be effective in providing insurance to the traditional and subsistence sector, partly because of the poor prospects for profits in this line, and also due to their concentration on organized and commercialized trade, and the industrial sector. Most importantly, the low capital base of private companies in developing countries is a crucial handicap. Nevertheless, to the extent that private companies are able to enter this area, the State should facilitate the process by first providing a level playground (in some countries legislation may have to be modified for the purpose), and by giving the necessary fiscal incentive. In markets where private companies are small and unable to make headway because of certain inherent constraints, particularly the inadequacy of capital, an agricultural insurance company sponsored by the insurance sector could be considered. Parastatal organizations, however, would have to continue to play a significant role here. The study does not go into the much discussed issue of privatization, but as far as agricultural insurance is concerned, it is becoming clear that financial discipline and accountability have to be injected into the operation of parastatal bodies engaged in agricultural insurance. There is a clear need for "commercialization" of their operations.

8. Insurance of the risks of the emerging and semi-commercial and of the commercial and specialized productions systems has begun, but organized efforts have not yet been made in this direction. Substantial opportunities exist for private sector companies in this area. In fact, the time has now

come for private companies to extend their operations to, inter alia, medium-sized farms, i.e. those supplying their output to processing units, plantations of tea, coffee, cocoa, rubber and oilseeds, social forestry, cultivation of seeds, horticulture, poultry farming, aquaculture, greenhouses, hydrophonic vegetables, and non-traditional or specialized items for export such as production of vegetables, fruit and flowers under strict quality control.

9. An examination of the crop insurance schemes of several countries in terms of crops covered, scope of cover, premium rate, indemnity and loss assessment and of the livestock, poultry and aquaculture schemes of other countries in terms of the main variables, namely, geographical location, species or breed, mortality levels, age within which insurance is offered, perils covered, sum insured, premium rates and farm management strategies highlight the following:

(a) Schemes of livestock, poultry and aquaculture insurance can be self-supporting and commercially viable - in fact, this is the case in many countries. For this to be achieved, however, the schemes must be based on technical knowledge of the operational processes involved. For this purpose it is necessary to employ veterinarians and other experts. Maintaining a linkage with animal husbandry departments, extension services and other specialized institutions is also necessary. An "active" underwriting policy has to be pursued and, wherever necessary, strict conditions imposed enforcing the adoption of precautionary measures. Management practices at the farm level are an important factor. Adequate systems of loss assessment are also important.

(b) The support of the government and its various departments is usually available not only for schemes meant for traditional and subsistence farmers but also for commercially-oriented farmers, as it is realized that this will bring about an improvement in risk management and stabilize agricultural productivity. It is worthwhile, from both the marketing and servicing points of view, to develop linkages with agencies such as banks and other financial institutions, cooperatives, trade associations, marketing boards, manufacturers connected with agriculture either as suppliers of inputs or as processors of the produce, research institutes and universities.

(c) Keeping strict control over administrative expenses is essential for the success of agricultural insurance. Group insurance is a noteworthy strategy from this point of view. It also helps to minimize the problem of anti-selection and moral hazard.

(d) For insurance companies that are not familiar with the rural and agricultural environment, a sound approach would be, first, to take up simple insurance schemes already devised for the urban sector with the necessary simplification and modification. Insurance of dwellings, stables, stores and shops, equipment and machinery, handicrafts and household production, and the small sector, accident and hospitalization and life insurance are some of the lines to be pursued. Once a foothold has been gained in the area, schemes more directly related to agriculture could be taken up. Insurance of these risks, in fact, constitutes an important part of the total business of many agricultural insurance organizations, in both developing and developed countries.

(e) The penetration of insurance into most developing countries is poor. At the same time, the image of insurance is far from flattering. It is a complex situation, and initiatives have to be taken in many directions. A cost-effective organizational infrastructure has to be put in place to service rural business. Apart from parastatal organizations and private companies, mutuals, cooperatives and pools have a role to play. On the other hand, the marketing personnel who are really the "cutting edge" have to be strengthened by proper training.

(f) Considerable effort is needed in the field of insurance education, and research into various operational aspects of agricultural insurance. In particular, though some studies have been made and literature is available on crop insurance, the literature on livestock, poultry, aquaculture and other lines of agricultural insurance is negligible. This deficiency has to be met.

(g) Risk management is an important benefit of agricultural insurance. This discipline, which is being increasingly adopted by the insurance sector in recent times, involves the study of risks, their measurement, containment and control. Insurance is seen as a mechanism for transferring irreduceable risks to a professional organization. The most significant aspect for our purposes, however, is that the insurance system leads to control and reduction of risks. The imposition of strict conditions of insurance leads to the improvement of risks, thereby preventing losses. For example, the requirement of vaccination and the steps to be taken to control diseases in animals, poultry, other birds and fish, leads to enforcement of better animal husbandry systems. It is necessary for insurance companies to keep this perspective in mind and to lay stress on the steps being taken to improve risks.

(h) Agricultural insurance also has a role to play in the protection of the environment. By means of suitable warranties and conditions in the insurance contract, environment-friendly measures can be initiated.

(i) International reinsurance is vital for the development of agricultural insurance in developing countries. In view of the limited capacity of domestic markets to absorb agricultural risks within the individual countries, the utilization of this mechanism for enhancing underwriting capacity is of great significance. Reinsurance support is available, but only when the schemes are based on technical considerations and are financially viable. Reinsurance also imposes a degree of financial discipline.

(j) The limitations of agricultural insurance should be recognized and it should not be idealized. Insurance should be viewed as one of the several financial services available, and its basic role is supportive. By itself it cannot increase productivity or be a panacea for the many problems of agriculture. Insurance should not be seen or sought to be promoted as a solitary effort but as a component of a package of services that need to be extended to the agricultural sector. In fact, agricultural insurance can be most effective if it is conceived and implemented as a part of this broader framework.

10. The difficulties to be overcome in introducing agricultural insurance schemes into developing countries, and extending them in a more effective manner than at present are many. The biggest hurdle is fear of the unknown. The dynamics of the situation are complex, and the web of agricultural insurance has to be developed patiently, strand by strand. However, the process should be initiated sooner rather than later.